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Effects of Board Independence and Institutional Ownership on Earnings Management of Listed Oil and Gas Marketing Industries in Nigeria

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ABSTRACT

The study examined the effects of Board Independence and Institutional ownership on Earning Management of Oil and Gas Marketing Companies in Nigeria. A total of Eight (8) Oil and Gas Marketing Companies was used, covering seven years period (2010-2016). Data for the study were extracted from the Firms' audited annual reports and accounts of the companies. Modified Jones Model (1995) was employed for calculating discretionary accruals as proxy for earnings management. Moreover, independence variables are Firm size, and Audit Quality. Data was subjected to detailed analysis through descriptive and inferential statistics with help of STATA software. After running the regression, a robustness test was conducted for validity of statistical inferences. The result revealed that Board Independence and Ownership structure have no significant on Earnings management. It is therefore recommended that The SEC should come up with a bench mark as to the numbers of independent non-executive directors in this Oil and Gas Marketing Companies should have on its board.

Keywords: Earnings management, Board Independence, Ownership structure, Discretionary Accrual

Introduction

Earnings management is seen as an attempt by management to induce, influence or manipulate reported earnings by using specific accounting method or changing methods, recognizing one-time non-current items, deferring or escalating expenses or revenue transactions or using other methods designed to influence short term earnings (Rahman, Muniruzzaman Sharif 2013). This practice, according to Levitt (1998) "causes an erosion in the quality of earnings, and consequently the quality of financial reporting will lose out to illusion". Earnings management is the practice of managerial actions that are reflected in a company's financial reports either to give the intuition of smooth periodic or annual earnings, to show high profits in a given year at the 'expense' of lowering reported earnings in the future or to show little profit in a given year so that in future years reported profits will be higher.

The practice of Earnings management is a conscious attempt to arrive at a preferred level of earnings using different means (Bello, 2011). Earnings management can take many forms and include various deceitful actions as a result of managers' use of opinion in financial reporting. Earnings management, however, involves the preparation of financial reports in accordance to what correlates with the effort of the managers, such as to improve the worth of the company and that of the accountants. The flexibility of the accounting regulations makes it easy for managers to manage earnings and this arises the doubt to the quality of financial reports (Okoye & Alao, 2008).

Financial accounting reports are produced to confirm the true and fair position of dealings of business entities so that stakeholders and other users of such information can take conversant decision. However, current accounting practices allow a degree of choice of policies and professional judgment in determining the methods of measurement, criteria for detection, and even the definition of the accounting entity has given rise to deliberate non-disclosure of information and manipulation of accounting figures, thereby making the business to be more profitable (or less profitable for tax purposes) and financially stronger than it's supposed to be.

Global corporate scandals that took its toll with the collapse of prestigious companies like Enron and Worldcom (2001), reiterated the need for an investigation into the quality of financial reports and increased the clamoring for a better governance mechanism globally. Bowen, Rajgopal and Venkatachanlam, (2003) observed that accountants and financial managers have systematic deficiencies in complying with accounting standards and governance systems to produce financial information as such cook their accounts to suit either their needs or the need of their shareholders as the case may be.

These issues has adversely affected so many developing economies such as Nigeria, in which many corporations where faced with setbacks due to capital market scandal which results in monetary crisis in the economy, such scandal involve large companies such as African Petroleum Plc, Cadbury Nigerian Plc, and Lever Brothers Plc (Ajibolade 2008). The insolvency of these giant corporations, stemmed from influencing earnings, due to dishonest and untruthful practices by the board of directors and weak Corporate Governance Mechanisms (Fodio 2013).

Therefore, the recent global financial crises have emphasized the need of transparency in presentation of financial information. Managers used their control over the firms to achieve their personal objectives at the expense of stakeholders (Uwuigbe et al., 2012; Uwuigbe, 2013). Kang & Kim (2011) opined that management could influence reported earnings by making accounting choices or operating decisions discretionally. Therefore, the corporate scandals of earning management highlighted above is not dependent on a particular factor or an attribute of companies or firms' characteristics, such as firm size, audit quality, board independence, institutional ownership, audit committee size, gender size, corporate governance e.t.c..

Although, previous study examined the relationship between firm's characteristics and earning management in developed countries such as Prity Kumari & Pattanayak (2015), Amarjit Gill, Nahum Biger, Harvinder S. & Neil Mathur (2013), Jordan, Clark & Hames, (2010), Yang & Krishman, & kuang & Sharma (2013) most notably in the United States, Russia and France. There is a study that investigates the influence of board characteristics on the financial performance of listed deposit money banks in Nigeria (Odudu, James & James, 2016). Also, Atu, Atu, Enegbe & Atu, (2016) studied determinants of earnings management in Nigeria quoted companies.

However, some in the existing literature found to have investigated the impact of firm structural characteristics and financial reporting quality of listed deposit money banks in Nigeria were Olowokure, Tanko, & Nyor, (2016) Bala & Kumai, (2015). Ibrahim, Bala & Garba, (2015) are in agreement that Board characteristics are related to earning management of listed food and beverages firms in Nigeria. Empirical evidence from previous studies have shown that audit firm's size is a fundamental strategy that can lead to cash based earning management in Nigeria companies (Uwuigbe, Ranti, & Bernard, 2015; & Okolie, 2014).

Man & Wong (2013) concluded that Board independence had a negative effect on earning management practices. Also, Raheel (2017) revealed that depict a significant positive impact of Institutional Ownership on Earnings management, which means that increase in institutional directorship will lead to increase in earnings management

Literature has shown that there are little or no studies on the oil and gas industry in developing countries particularly in Nigeria, as the existing studies were only conducted in U.S.A, Russia and France. Thus, indicating that there is limited literature on the effect of board independence, and institutional ownership on earnings management in African particularly in Nigeria.

The following research questions and objectives were developed in view of the above research problem: Does Board Independence affect Earnings Management of listed Oil and Gas Marketing Companies in Nigeria? And Does Institutional Ownership affects Earnings Management in listed Oil and Gas Marketing Companies in Nigeria?

This study seeks to examine the effects of Firm's Characteristics on Earnings Management of listed Oil and Gas Marketing companies in Nigeria. However, it is set to achieve the following specific objectives: To study the effect of Board Independence on earnings management of listed Oil and Gas Marketing companies in Nigeria. To determine the effect of Institutional Ownership on Earnings Management of listed Oil and Gas Marketing companies in Nigeria.

To achieve the objectives of this study, the following hypotheses were developed:-

i. Board Independence has no significant effect on Earnings Management of listed Oil and Gas Marketing companies in Nigeria.
ii. Institutional Ownership has no significant effect on Earnings Management of listed Oil and Gas Marketing companies in Nigeria.

II. Literature Review

Management normally make used of some strategies in achieving certain targeted earnings. Earnings management likely occurred where there are lack proper monitoring systems in place and some managers take opportunity of the flexibility of the accounting standards. The accounting standards and procedure have given managements the opportunity to use their own judgement in the application of the standards in preparing their records, for instance the estimation of depreciable value or changing depreciation methods and a lot more others. Management can decide on which accounting standards to use that will favour the organization in managing the earnings towards the directions that are favourable to the firms Marinakis (2011).

Levit (2003), "Earnings Management is a gloomy area where accounting is being perverted, where managers are cutting corners; and, where earnings reports the desires of management rather than the true financial performance of the company".

The definition above seems earnings management as a report of what they desire instead of the true statement performance of the company. The assumption is that managements have personal motives to achieve and it is on this basis that they report their earnings. For instance, if management's incentive is tied to earnings then management will prefer to report higher earnings in order to earn higher incentives.

Rahmani & Akbari (2013) identified the association of size of firm and capital structure with the management of earning in Iran. 90 firms were sample from the total listed firms on Tehran Stock Exchange and secondary data was employed over the period of 2008 to 2012. Discretionary accruals were used as proxy to determine the earning management using Modified Jones model. Total assets logarithm was used as tool for the computation of firm characteristics. Gearing ratio was used to measure the capital structure. The study indicated the significant positive effect of firm characteristics and capital structure on earning management. It revealed that the firms having the more debt therefore required watch dog to discourage the practices of earning management.

Uwuigbe, Ranti, and Bernard, (2015) assessed the effects of firms' characteristics on earnings management of listed firms in Nigeria and the findings revealed positive and significant association between firms size and earning management while Bassiouny, Soliman and Ragab, (2016) concluded that insignificant relationship exist between firm size and earning management.

Audit committee plays an important role in monitoring management to protect shareholders' interest (Hasan & Ahmed, 2012). The code of best governance practice in Nigeria requires that the committee should be largely independent, highly skill, competent and possess high degree of integrity. (Hasan et al. 2012).

Audit committee has been explored in prior literature and how it relates to earnings management using various constructs of audit committee effectiveness such as size of the board (Yermack, 1996: Xie, Davidson & DaDalt 2003), composition and independence (Klein, 2002), audit committee meetings (Beasley, 2000), financial expertise of committee members (Kalbers & Fogarty, 1993), and financial motivation of independent directors (Chtourou, Bedard & Courteau., 2001). In the existing literature, (Hassan, 2011) observed that more attention has been given to financial expertise as a construct of board competence.

III. Methodology

The data is panel in nature and as such the study is cross-sectional; this is because several firms were observed over a period of seven years (2010–2016). Both descriptive and inferential statistics was used to analyze data. Descriptive was employed in calculating mean, median, standard deviation, maximum and minimum values of samples data. Inferential statistics comprises of correlation and regression, correlation also used to determine the relationship between dependent and independent variables while regression was employed in testing the hypotheses of the study. Discretionary accruals was used to measure earnings management being the dependent variable while, board independence and institutional ownership served as proxies for measuring firms' characteristics

The population of the study consist of all the Eight (8) Oil and Gas Marketing Companies in Nigeria, specifically oil companies that are quoted on the Nigerian Stock Exchange as at January, 2017. These companies engaged in oil marketing of petroleum products as well as oil and gas exploration and production. Therefore, all the oil marketing companies that are quoted on the NSE and produce financial reports during the period 2010-2016 formed the population of the study.

Secondary data was used. The source is mainly from audited financial statement of the oil and gas marketing industry and accounts for the period 2010-2016. This comprises of income statements, statement of financial position, cash flow statement and Notes to Accounts. This sourced from Nigerian Stock Exchange FactsBook and Financial Statements of the companies.

The data for this study was, properly coded and analyzed in other to obtain a meaningful report using Microsoft Excel. Descriptive and inferential statistics was used in analyzing the data collected. Descriptive statistics used in calculating mean, median, standard deviation, maximum and minimum of the variables. Panel Regression analysis employed to determine the effect of independent variables (board independence and ownership structure) on dependent variable (Earnings Management). The STATA statistical software was used.

Measurement of Variables

Variable	Measuring tool
Dependent Variable	
Earnings Management	Discretionary Accruals Modified Jones Model 1995
Independent Variables	
Board Independence (BI)	A dummy variable that takes the value of one if the proportion of independent non-executive directors to total board members is above sample median, and zero otherwise.
Institution Ownership (IO)	The percentage of shares owned by institutional investors divided by the total number of shares.
Control variable	
Cash Flow from Operations (CFO)	Cash flow from operations deflated by total assets

Adapted from Authors

This shows how the variables of the study measured.

Dependent Variable:- The dependent variable in this study is earnings management and measured by using Discretional Accruals (DA). Accrual approach to earnings management adopted due to the fact that, the estimation of the scope of earnings management is better served with accrual models though the use of discretional line items is best used for accuracy in detection. Also, this approach makes it easier to manage earnings via credit sales than cash collections. In addition, it attempts to control for the endogeneity bias in the original. More so, according to Uwuigbe et al. (2014) and Uwuigbe et al. (2012), this approach is one of the most famous and most frequently used models to detect earnings management. Hence, the modified Jones model of estimating discretional accruals was used. According Modified Jones Model, this approach accruals can be computed by using the following formula.

DA= TA –NDA

Where;

DA= Discretionary Accrual

TA = Total Accruals which are equal to cash flow from operation minus Net Income.

NDA = Non-Discretionary Accruals which may be computed at the end in the following way

$$\text{Total accruals}/A_{t-1} = a1\left[\frac{1}{At-1}\right] + a2\left[\frac{\text{change in Rev} - \text{Change in A/R}}{At-1}\right] + a3\left[\frac{PPE}{At-1}\right] + \varepsilon$$

Where:

A_{t-1} = is total assets at the end of year t-1

Change in revenue: = is revenue in year t less revenue in t-1

Change in A/R = is net receivable in year t less net receivable in year t-1

PPE = is gross property plant and equipment at the end of year t.

a1, a2, a3 = are firm specific parameters

t-1 = Time coefficient

ε = firm specific discretionary portion of accruals

The econometric model developed for this study comprises of the following equations:

The econometric model developed for this study comprises of the following equations:

$$Y = \alpha + \beta_1 X_{it} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(1)$$

$DAC_{it} = \alpha + \beta_1 INSOWN_{it}$ ....(2)

$DAC_{it} = \alpha + \beta_2 BOARDIND_{it}$ ……………………………………………………..……………….(3)

$DAC_{it} = \alpha + \beta_1 INSOWN_{it} + \beta_2 BOARDIND_{it}$ ....(4)

$DAC_{it} = \alpha + \beta_1 INSOWN_{it} + \beta_2 BOARDIND_{it} + \beta_3 CASHF_{it} + \varepsilon_t$ ……..……. …………………………(5)

Where

α - is constant

$\beta_{1-}\beta_5$ are the coefficient of the independent variables

ε - is the error term

Y- Dependent variable

X – Independent variables

i = number of firms under observation

t = time

IV. Results and Discussion

Robustness test was conducted in order to improve the validity of statistical inferences. Multicolinearity test:- Since the study employs multiple regression model, the association between the predictor variables (dependent) is unavoidable. Where the association is highly correlated, multicolinearity exists. This is tested to see the possibility of its existence or otherwise. This is done using Variance Inflation Factor (VIF) and tolerance value

Heteroscedasticity test:- The study deals with observations that constituted different sizes, some are in ratios while others in units, and that heteroscedasticity often occurs when there is a large difference among the sizes of the observations. For that, we run for Heteroscedasticity test, with the help of Breusch-Pagan test.

This shows the summary of data. It includes mean, standard deviation, minimum and maximum. The average value of the data is known as mean, standard deviation is the average variation in the data. Summary also shows the smallest value (minimum) of the data as well as the largest value (maximum). Summary of the data statistics covering from the year 2010 to 2016 for the population of 8 oil and gas marketing companies listed on Nigerian Stock of Exchange.

Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
DA	-1.670668	5.174000	-2.600581	9.959810
BI	.6405498	.1165093	.4	.8333333
IO	.5495636	.1534184	.004531	.7439974
CASHF	.1119386	.1320294	-.2660351	.4900729

Source: STATA Output 2017

The Discretionary Accruals (DA) has been measured by using Modified Jones Model. The mean value of DA for the selected firms is negative -1.67060668 in million, whereas maximum value is 9.959810 million and minimum value is negative -2.600581 and Standard deviation captured is 5.170010.

Board Independence (BI) has been measured by percentage of non-executive directors in the total board member. The mean value of Board Independence for the selected firms is 0.6405498, which means that on average 64% of the board members are non-executive directors, whereas maximum value is 0.8333333 which means 83%, standard deviation captured 0.1165093. The value of minimum is negative -4.

Institutional ownership (IO) has been measured by percentage of shareholding held by institutions in the total shareholding of the selected firms. The mean value of Institutional Ownership for selected firms is 0.5495636 which means that on average 55% of the shareholding is with institution, wherein standard deviation value captured 0.1534184. The minimum and maximum are 0 .004531 and 0 .7439974 respectively.

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Cash flow (CASHF) has been measured by cash flow from operations deflated by total assets of the selected firms. The mean value of CASHF for selected firms is 0.1119386 which means that on average 11% whereas standard deviation value captured 0.1320294. The minimum and maximum are -0.2660351 and 0.4900729 respectively.

Correlation Matrix

The correlation matrix was used to determine the degree of relationship between variables of the study. These associations among the variables of the study are presented in Table below. It gives the existence of relationship among the variables which can be either positive or negative. Value closer to 1 depicts that the two variables are highly positively related/effecting each other indicating multicollonearity.

	DA	FSIZE	BI	AQ	IO	CASHF
DA	1.0000					
BI	-0.2593	0.7928	1.0000			
IO	0.1504	0.4693	0.4372	0.4431	1.0000	
CASHF	-0.0869	0.2606	0.1557	0.2704	0.4150	1.0000

Source: STATA Output 2017

The correlation matrix shows that DA has negative relationship with BI and CASHF which is -0.2593 and -0.0869 respectively which means that increase in Board Independence and Cash flow lead to reduction in earnings management. Moreover, there is positive relationship between DA with and IO with 0.1504 which means that IO lead to increase in earnings management and vice vers

a, however the positive relationship between DA and IO is a little bit strong.

It can be observed that the relationship between the independent variables themselves are not significant, an indication of absence of multicollonearity. This can be clearly observed from the two indicators (i.e. Tolerance value and Variance Inflation Factor (VIF) which are within less than 1 and less than 10 respectively.

Regression Results

VARIABLES	***POOLED EFFECT***	***RANDOM EFFECT***	***FIXED EFFECT***	***ROBUST FIXED EFFECT***
	Coefficient			
DA	17,2091 (4.4573)	16.6489 (4.9926)	11.7274 (6.8589)	11.7274 (2.2661)
BI	-17.3119** (10.2358)	-23.8480** (11.5048)	-29.1714** (14.5604)	-29.1714*** (6.6648)
IO	17.2543* (6.4278)	13.9036* (8.2583)	5.5937 (13.6784)	5.5937 (16.4794)
CASHF	-15.2594 (12.2632)	-12.0036 (11.8775)	-7.3351 (12.2248)	-7.3351 (6.3544)
Breuch-Pagan	0.42			
Hausman Test		0.47		
VIF		2.0		

NOTE:- ***, ** and * represent 1%, 5% and 10% level of significant respectively.
Value in ( ) represent standard error

Table reveals the regression result which was estimated using panel model. The study estimated pool, random, and fixed effect models. Also performed Breuch-Pagan and Hausman test to validate the appropriate results to be presented. The P-value of Breuch-Pagan test presented in shows that its significant at 5% which implied that the pooled is appropriate. However, given the fact that our data are panel, we proceeded with Hausman Test to decide between Random and fixed model of which one is appropriate. The P-Value of Hausman is not significant which implied that fixed is more appropriate. However, fixed model has a problem of serial correlation which is tackled with robust fixed effect model which is used for this study.

Regression Results (Robust Fixed Effect)

Variables.	**Coefficient**	**P-Values**
C	11.7274	0.0001
BI	- 29.1714	0.003
IO	5.5937	0.744
CASHF	-7.3451	0.286
R -squared	0.1907	
Adjusted R-squared	0.1098	
Wald chi2	18.38	
P > chi2	0.0025	

Source: STATA Output 2017

Table presents the summary of regression result i.e Robust fixed effect. It reveals the coefficient of the dependent and independent variables with their p-values. The r-squared statistic result shows a value of 0.1907 and an adjusted r-squared of 0.1098.

Testing of Hypotheses

Hypotheses One: Board Independence and Earnings Management

H_{01}: Board Independence has no significant effect on Earnings Management of listed Oil and Gas Marketing Companies in Nigeria.

Summary of Board Independence and Earnings Management

Variables.	**Coefficient**	**P-Values**
BI	- 29.1714	0.003

Source: STATA Output 2017

Also from the above table 4.7, it is obvious that there is negative and significant relationship between board independence and earnings management of oil and gas marketing companies in Nigeria with a p-value of 0.003 and a coefficient of -29.1714, which is said to be significant at 5%. This indicates that board independence is negatively impacting on earnings management of oil and gas marketing companies in Nigeria and the implication of this result is that the more independent the board of directors of these companies is the better at reducing earnings management of oil companies in Nigeria. This therefore serves a justification of rejecting the null hypothesis formulated which stated that there board independence has no effect on earnings management of oil marketing companies in Nigeria. This result is in agreement with that of Talbi, Omri, Guesmi and Ftiti (2015) did study to investigate the efficacy of board characteristics in restraining management's earning management, whereby results showed that board independence played significant role in controlling earnings management.

Hypotheses Two: Institutional Ownership and Earnings Management

H_{02}: Institutional Ownership has no significant effect on Earnings Management of listed Oil and Gas Marketing Companies in Nigeria.

Summary of Institutional Ownership and Earnings management

Variables.	**Coefficient**	**P-Values**
IO	**5.5937**	**0.744**

Source: STATA Output 2017

From the table 4.9 above, it shows a result of positive and no significant relationship between institutional ownership with earnings management of oil and gas marketing companies in Nigeria. From the p-value of 0.744 and a positive coefficient of 5.5937, reveals that institutional ownership impact positively on earnings management. The implication of this result is that ownership by institutions may not serve as means of reducing earnings management and this therefore provides a basis for the non-acceptance of the null hypothesis formulated which stated that institutional ownership does not have effect on earnings management of oil marketing companies in Nigeria. The findings above are also in line with that of Odudu et al. (2016) that foreign directors is significantly and positively correlated or influenced the earnings management.

Finally, the model also revealed that the control variable, cash flow is negatively but not significantly related to earnings management of oil and gas marketing companies in Nigeria. From the p-value of 0.286 and a coefficient of -7.3351, it therefore signifies that the firms with high cash flows are even likely to be incapable of reducing earnings management of oil and gas marketing companies in Nigeria than the firms with less or lower cash flows.

On the overall, the combined and overall impact of the firm characteristics on earnings management of oil and gas marketing companies in Nigeria is depicted on the model summary of the regression results. The Wald Chi2 of 18.38 which is significant at 1% (0.0000) reveals that the model is well fitted, while the coefficient of determination R^2 of 10.98%, explains the individual variation of dependent variable (discretionary accruals) as a result of the changes in the independent variables. It can therefore be said conclusively that firms characteristics (firm size, audit quality, board independence and institutional ownership) and cash flow have combined predictive power of 10.98% in impacting on earnings management of oil and gas marketing companies in Nigeria, while the remaining 89.02% is accounted for by other factors which are not captured in the model used for the purpose of this study.

V. Summary and Conclusions

This section presents conclusions of the study.

(i) The analysis also revealed that Board independence negatively impacted on earnings management of oil and gas marketing companies in Nigeria and the relationship between independent variable (BI) and dependent variable (DA) was significant.

(ii) Institutional ownership impacted positively on earnings management and the relationship was not significant.

Based on the findings and conclusion of this study, the following recommendations were made:

i. It is recommended that concerned stakeholders and regulators can take measures to increase the percentage of non-executive directors, put restriction on CEO duality and formulate strategy to decrease institutional ownership in order to restrict earning management.

ii. It is also recommended that The Security and exchange commission should come up with

a bench mark as to the numbers of independent non-executive directors in this Oil and Gas Marketing Companies should have on its board. This is seen necessary because of the impact of independent non-executive directors will have in the operation of the business.

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